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No. 92-97

In the
Supreme Court of the United States

OCTOBER TERM, 1993

NORTHWEST AIRLINES, INC., ET AL.,
Petitioners,

v.

COUNTY OF KENT, MICHIGAN, ET AL.,
Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT.

BRIEF OF AMERICAN ASSOCIATION OF AIRPORT EXECUTIVES AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENTS.

Interest of *Amicus Curiae*.

The American Association of Airport Executives ("AAAE") was founded in 1928 to assist airport managers in fulfilling their

responsibilities to the nation's airports, the traveling public and the airport communities. The AAAE has members from almost every commercial airport in the United States; its membership includes managers at airports that enplane 99 percent of the nation's airline passengers. The AAAE represents the interests of airport managers before Congress and federal agencies, and its staff works closely with federal officials to make the nation's airports safe and efficient.

The nation's airports are an essential link in the air transportation system. In order to meet the needs of the traveling public and aircraft operators, including the commercial airlines, the airports must be adequately funded. The AAAE has filed this brief as *amicus curiae* to show, contrary to the arguments of the petitioning airlines (the "Airlines") and the Air Transport Association of America (the "ATA"), that the economics of the nation's airports do not provide any basis for the relief the Airlines seek. Rather, if this Court were to reverse the decision of the Court of Appeals, the ability of the AAAE's members prudently and effectively to manage the nation's airports could be greatly impaired. The AAAE respectfully urges the Court to affirm the Court of Appeals' decision.[1]

Summary of Argument.

The Airlines and the ATA claim that airports have generated "excess" non-aeronautical operating revenues by using the compensatory ratemaking method, and that these so-called "surpluses" show that airport charges to commercial aircraft operators for the use of airport facilities are "unreasonable" under the Anti-Head Tax Act (the "AHTA"), 49 U.S.C. App. § 1513, and the Commerce Clause, U.S. Const., art. I, § 8,

[1] Letters of consent for the filing of this brief as *amicus curiae* have been submitted to the Clerk in accordance with Rule 37.3 of the Rules of this Court.

cl. 3. This claim has no evidentiary basis and reflects distorted views about how airports finance their facilities.

Airports that use the compensatory method base their charges to the airlines on the actual costs of the airport facilities the airlines use. These charges have marginal impact on the airlines and have not contributed to recent airline financial problems.

The generation of operating income is not evidence of excessive charges, it is evidence of prudent airport management. Airports have massive capital requirements that can only be met if they have earnings sufficient to meet their debt service obligations.

Congress has directed the nation's airports to be "as self-sustaining as possible" and has recognized, by funding the Airport Improvement Program and authorizing the use of passenger facility charges, that airports cannot be expected to raise all the capital they require even if they have operating surpluses.

Here, the Airlines seek to deprive an airport of its non-aeronautical operating income, by forcing it to charge less than the actual costs of the airport facilities the Airlines use, without assuming any obligation to ensure that the Airport is able to meet its own capital requirements.

Airport owners generally use two alternative methods to determine what they charge airlines for use of the airport: the "compensatory" method, under which the airlines are charged only the actual costs of the facilities they use, and the airport retains non-airline revenues and control of its capital program; and the "residual cost" method, under which the airlines agree to pay whatever costs remain unpaid after all non-airline revenues are collected, and in return for this commitment, the airlines share control of the airport's capital decisions. Both of these methods align control of the revenue stream with financial responsibility for the airport.

The Airlines seek to impose an unprecedented combination of these methods which would give them the benefit of non-air-

line operating income without the burden of assuming the risk of non-airline operating losses. If the Court grants the relief the Airlines seek, the revenue streams that support the debt obligations of airports throughout the country will be threatened.

Neither this Court nor Congress has ever suggested that it is unreasonable for airport owners to recover their actual costs of providing airport facilities to the airlines. There is no justification for the below-cost charges the Airlines continue to pursue in this appeal. The Court should reject the Airlines' claims and declare that the managers of this nation's airports may continue to use the compensatory method to set their airline charges.

Argument.

I. There Is No Evidence That Airport Charges Are Excessive.

The Airlines and the ATA claim that the nation's airports, including the Kent County International Airport, have accumulated "excess revenues" and have therefore charged the Airlines unreasonable rates which should be declared unlawful under the AHTA and the Commerce Clause. The Airlines suggest that these charges have led to their recent financial difficulties. There is no evidence, however, that the nation's airports in general, or the Kent County International Airport in particular, have charged unreasonable rates, accumulated excess revenues, or contributed to the financial problems of the Airlines. In fact, the economics of the nation's airports compel the affirmance, not the reversal, of the Court of Appeals' decision sustaining the use of the compensatory ratemaking method by Kent County.

A. *Airport Charges Have Not Caused Massive Airline Losses.*

The ATA argues that airport charges have "risen virtually unimpeded" and implies that the increase in airport charges has been a significant cause of the airlines' loss of $10 billion over the past three years (ATA Brief, pp. 6-8). The Court should give no weight to these claims, for two basic reasons.

First, there is no evidence that airport charges have exceeded the *actual costs* of providing airport facilities to the Airlines. The courts below correctly found that the airport in Kent County only recovered its "break-even" costs from the Airlines and that the compensatory ratemaking method, which is used in Kent County and at many airports throughout the country, is *designed* to produce this result. *Northwest Airlines, Inc.* v. *County of Kent, Michigan*, 738 F.Supp. 1112, 1115, 1119 (W.D.Mich. 1990), *aff'd*, 955 F.2d 1054, 1057 (6th Cir. 1992).

Second, airport charges remain only a small fraction of the airlines' total costs and total revenues. Nationwide, charges to commercial aircraft operators for the use of airport facilities average only about 4% of total airline costs. Airport Council International-North America, Airport Costs and the U.S. Airline Industry (1993), p. 14. For the Kent County International Airport, the previous charges accepted by the Airlines were only 1.2% of the Airlines' revenues from their Grand Rapids operations, and the challenged charges would have been only 1.5% of their revenues. *Northwest Airlines*, 738 F.Supp. at 1119.

It is, therefore, not surprising that when Congress recently created the National Commission to Ensure a Strong Competitive Airline Industry to investigate the financial health of the airline industry, the Airlines did not claim and the Commission did not find that airport charges have played a significant role in

the industry's losses in recent years.[2] In fact, the Commission's final report never mentions airport charges as a factor in the airlines' current financial predicament. *See* Change, Challenge and Competition: A Report to the President and Congress (Aug. 1993).

B. *Airport Charges Have Not Produced Financial Windfalls.*

The ATA also claims in its brief (pp. 8-9) that "many of the nation's airports are . . . generating excess revenues" and producing "financial windfalls." The ATA bases this claim upon what it says are the results of the AAAE's own Survey of Airport Rates and Charges 1991-1992 (undated). Unfortunately, the ATA has badly distorted the Survey in an attempt to mislead the Court.

The AAAE's Survey compiles the operating revenues and operating expenses of airports throughout the country. The Survey does not, however, purport to reflect the *costs of capital* at the nation's airports.[3] It is meaningless to say, as the ATA does, that the existence of *operating income* shows that airports have generated "excess revenues" or "financial windfalls." The nation's airports already have enormous capital costs, and

[2] *See* Airport and Airway Safety, Capacity, Noise Improvement, and Intermodal Transportation Act of 1992, Pub. L. 102-581, tit. II, § 204(c)(1) (directing the Commission to "make a complete investigation and study of the financial condition of the airline industry") and § 204(d)(3)(G) (specifying "user fees imposed on United States airlines" as a matter to be addressed); H. Rep. No. 22, 103rd Cong., 1st Sess. (1993) (not mentioning user fees as a significant factor).

[3] From time to time, the AAAE surveys its members about the rates each airport charges air carriers and concessionaires, the type of cost recovery system each airport uses (compensatory or residual), the amount of revenue raised from each type of user, and the charges for the use of each type of airport facility. The survey is intended to provide general information to the AAAE's members as to how their charges compare to the rates at similar airports throughout the country. The survey is not designed to provide a complete financial picture of any specific airport or of the airport industry as a whole.

many airports plan huge capital improvement programs. A brief look at the airports singled out by the ATA demonstrates this critical point.

As reported in the AAAE Survey, the three major airports operated by the Port Authority of New York and New Jersey (John F. Kennedy International Airport, LaGuardia Airport and Newark International Airport) had a combined operating surplus of $304 million in 1991. This figure, however, does not take into account the airports' share of the Port Authority's administrative expenses ($48 million), the depreciation of airport capital investments ($100 million), or any allowance for debt service on the obligations of the Authority (which for all of its facilities was $295 million in 1991). Moreover, the Port Authority's current capital plan calls for additional investments at these airports of $2 *billion* during the five year period 1993-1997.

Similar patterns can be found at the Boston, Houston and Las Vegas airports highlighted by the ATA. The Massachusetts Port Authority produced an operating surplus at Logan International Airport of about $58.5 million in 1991, but its debt service and required reserve payments for the Airport were approximately $34 million. Meanwhile, the Logan Airport Capital Plan anticipates capital improvements of $1.3 billion over the next ten years.

While the AAAE's 1991-1992 survey showed net revenues of $52.3 million for the Houston Intercontinental Airport, the accumulated operating surplus generated by the Houston airport system, including Houston Intercontinental Airport, has been used to pay administrative expenses, to meet debt service obligations and to refund outstanding indebtedness and thereby reduce the debt service of the airport system. Over the next five years, the Houston airport system plans to spend about $812 million on capital improvements.

While the Las Vegas McCarran International Airport generated an operating surplus of about $66 million, it had debt

service obligations of about $60 million in 1991. By agreement with the Airlines, the remaining funds have been held for use on new airport capital projects, which are slated to cost about $600 million by the end of this century.

Finally, at the Seattle-Tacoma International Airport, the airlines have a residual cost *agreement* with the Airport which provides that the operating surplus ($43.5 million) should be devoted to debt service, coverage requirements and administrative expenses. During the next ten years, this airport expects to spend $1.3 billion on capital improvements.

In short, after existing debt service and future capital requirements are taken into account, there is no proof that any airports have accumulated "excess revenues" or realized "financial windfalls." Rather, the evidence is that the nation's airports, including Kent County International Airport, have capital needs that vastly exceed their retained operating income.

II. The Accumulation of Non-Airline Operating Income Is Consistent With Congressional Expectations.

It is the responsibility of state and local airport operators to build, operate, maintain and improve the nation's airports. Congress has required airport operators to set their charges for the use of airport facilities so that each airport is "as self-sustaining as possible." 49 U.S.C. App. § 2210(a)(9). To raise the capital required for airport construction and improvement, it is essential for an airport to generate operating revenues that exceed its operating expenses (that is, in the words of the ATA, to produce "excess revenue"). This so-called "surplus" is necessary to pay debt service, maintain required debt coverage and reserve funds, cover the up-front costs of projects that are eligible for federal grants and permit capital expenditures

on a pay-as-you-go basis.[4] A ruling that either the AHTA or the Commerce Clause prohibits airports from generating such "excess revenues," even when they only charge the airlines the break-even costs of the airport facilities they use, would cripple the efforts of the nation's airports to be "self-sustaining" and cannot be reconciled with the intent of Congress.

For many years Congress has recognized that it is very difficult for airports to be entirely "self-sustaining" and therefore has provided massive financial assistance through the federal Airport Improvement Program ("AIP"). Airport and Airway Improvement Act of 1982, Pub. L. 97-248, 49 U.S.C. App. §§ 2201 *et seq.*[5] Even with the AIP, however, Congress has recognized that the nation's airports cannot meet their capital requirements. As a result, Congress enacted the Aviation Safety and Capacity Expansion Act of 1990, Pub. L. 101-508, tit. IX, subtit. B, which amended the AHTA to permit airports to levy "passenger facility charges" ("PFC's") to augment their

[4] The "surplus" challenged by the Airlines is required by federal grant assurances to be used only for airport capital or operating costs. In order to receive federal grants under the Airport Improvement Program, an airport must provide assurances satisfactory to the Secretary of Transportation that "all revenues generated by the airport . . . will be expended for the capital or operating costs of the airport, the local airport system, or other local facilities which are owned or operated by the owner or operator of the airport and directly and substantially related to the actual air transportation of passengers or property." 49 U.S.C. App. § 2210(a)(12). Thus, as a matter of federal law any "excess" revenue must be reinvested in the airport. The Secretary has power to enforce this requirement. 49 U.S.C. App. § 2218.

[5] Congress declared that "the continuation of airport and airway improvement programs" is "required to meet the current and projected growth of aviation and the requirements of interstate commerce, the Postal Service, and the national defense." 49 U.S.C. App. § 2201(a)(2). Congress encouraged "airport construction and improvement projects which increase the capacity of facilities to accommodate passenger and cargo traffic, thereby increasing safety and efficiency and reducing delays. . . ." 49 U.S.C. App. § 2201(a)(11). From 1982 to 1992, the Federal Aviation Administration provided AIP grants of about $13 billion "to help airports sustain or increase their safety and capacity." U.S. Government Accounting Office, Airport Improvement Program, Opportunity to Consider FAA's Role in Meeting Airport System Needs, GAO/T-RCED-93-43 (May 26, 1993), p. 3.

ability to finance approved capital improvement projects.[6] 49 U.S.C. App. § 1513(e). See H. Rep. No. 581, 101st Cong., 2d Sess. (1990), p. 11 (over the years 1990-1995, airport capital improvement projects are expected to cost $50 billion).

It is implausible that when it mandated that airports become "as self-sustaining as possible," funded the Airport Improvement Program and authorized the use of PFC's, Congress intended that airports be stripped of the ability to generate the non-aeronautical operating income they must have to raise their own capital and pay required debt service.

III. The Relief Sought By the Airlines Would Undermine The Financial Integrity of the Nation's Airports.

The Airlines seek to compel the Airport to share its non-aeronautical operating surplus with the Airlines even though the Airport has only charged the "break-even" costs of the facilities the Airlines use and the Airlines have not agreed to assume any of the financial risks or obligations of the Airport. This result would be unprecedented and unwise.

Airport operators use two alternative methods to recover the costs of their airports: the "compensatory" method and the "residual cost" method. Under a compensatory method, such as the method used by Kent County, the airport charges commercial aircraft operators only the actual costs of the airport facilities they use; the airport itself retains any excess revenues derived from non-aeronautical sources and has sole responsibility for its own financial obligations and capital planning.

[6] The ATA makes the perverse argument that the adoption of the PFC legislation somehow makes "excess airport revenues . . . uniformly unreasonable" (ATA Brief, p. 12). This broad assertion completely misses the point. Congress reversed federal policy and loosened the constraints of the AHTA to permit the use of a specified form of "head tax" not because it found that existing airport revenues were excessive, but because it found that they were *inadequate* to meet the needs of this country's air transportation system.

Under a residual cost method, the airport and airlines *agree* that the airport will charge the commercial airlines whatever costs of the airport remain unpaid after all non-aeronautical revenues have been collected so that the airport is assured that it will break even overall. In exchange for this financial commitment to make up any revenue shortfalls, the airlines gain the ability to share the airport's concession revenues and to influence its capital planning.

Moody's has summarized the essential differences between these two methods this way:

> The fundamental differences between the residual and compensatory approaches . . . are reflected in who assumes the risk for financial operations and who has control over airport capital decisions. Under the residual approach, the airlines assume the risks by guaranteeing annual cash flow sufficient to keep the airport whole regardless of air traffic levels, concession revenue yields, operating expenses, and other financial factors. For this guarantee, airlines share in non-airline revenues in the form of reduced terminal rental and landing fee requirements, and exercise certain controls over capital decisions through MII provisions.[7] Conversely, under a compensatory approach the airport assumes the risk for financial operations by allocating to airlines only those expenses associated with airline space. Costs associated with concession, public and vacant airline rentable space are presumably funded by non-airline

[7] Majority-in-interest or "MII" provisions typically allow the airlines to disapprove significant capital expenditures. These provisions sometimes allow airlines to veto capital improvements that would aid competitors. Because of this potential for anti-competitive behavior, Congress has provided that MII provisions may not be invoked to restrict the construction of facilities financed with passenger facility charges. 49 U.S.C. App. § 1513(e)(9).

> [*sic*] revenues. By assuming this risk, the airport retains control over capital decisions and retains any excess of non-airline revenues over non-airline expenses.

Moody's on Airports, A New Look at Airport Debt In a Changing Environment (1991), p. 12.

The alignment of financial responsibility with control of the revenue stream is critical because most airports use revenue bonds to raise capital for airport improvement projects (Moody's, p. 7). The authorizing bond ordinances and trust indentures pledge airport revenue, rather than airport facilities, as security for the bonds. To reduce the risk of default, these indentures typically require net airport revenues to be at least 125% of annual debt service and require the funding of reserve accounts to ensure that the pledged revenue stream continues to flow to meet debt service obligations.

In this case, the Airlines seek to mandate an illogical and dangerous combination of the compensatory and residual cost methods which would force the Kent County International Airport to reduce its charges below actual costs whenever it has "excess" non-airline revenues. If the Airlines succeed in their appeal, they will have no financial obligation except to pay below-cost charges for their use of Kent County's airfield and passenger terminal; but the nation's airports will lose the ability to generate the non-aeronautical operating income they require to meet their capital needs.

This result would undermine the financial integrity of the airports throughout the country which rely upon the compensatory method to raise the revenues they need to maintain and improve the air transportation system. If the Airlines are entitled to the Airport's "surplus" non-aeronautical revenue, as they claim, the revenue streams that support the debt obligations of many

of the nation's airports will be threatened.[8] Such an outcome is not consistent with the intent of Congress or with the precedents of this Court.

This Court has never before outlawed the use of compensatory ratemaking. There is nothing in the AHTA or the Commerce Clause that warrants the relief the Airlines seek. The Secretary of Transportation, who is responsible for the administration of the federal aviation laws, has never suggested in any way that the use of the compensatory method is forbidden. The Airlines' misguided attempt to divert non-aeronautical revenues and destroy the ability of the nation's airports to meet the public's need for a safe and efficient air transportation system should be squarely rejected by the Court.

Conclusion.

For all of these reasons, the Court should affirm the decision of the Court of Appeals and permit the nation's airport managers to continue to use a variety of financial tools, including the compensatory method, to meet their obligations to the public to build, operate, maintain and improve this nation's airports.

Respectfully submitted,

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[8] The Airlines have never specified how the amount of concession revenues they claim is to be determined. Any requirement that airports reduce their cost-based charges to the airlines whenever they generate income from non-airline sources would, however, inevitably reduce the revenue streams pledged to secure many airport bonds and would, therefore, jeopardize the use of revenue bonds to fund the immense capital improvements required by the nation's air transportation system.